

103 KAR 30:120. Machinery for new and expanded industry.

RELATES TO: KRS139.010, 139.480

STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION, AND CONFORMITY: To interpret the sales and use tax law as it applies to exemption qualification for "machinery for new and expanded industry."

Section 1. Requirements for Exemption. The machinery and the appurtenant equipment necessary to the completed installation of such machinery, together with the materials directly used in the installation of such machinery and appurtenant equipment, which are incorporated for the first time into new or existing plant facilities, or which are installed in the place of existing plant machinery having a lesser productive capacity, and which are directly used in a manufacturing or processing production operation shall be exempt from the sales and use tax. The term "processing production" shall include: the processing and packaging of raw materials, in-process materials, and finished products; the processing and packaging of farm and dairy products for sale; and the extraction of minerals, ores, coal, clay, stone and natural gas. In summary, the following four (4) specific requirements must be met before machinery qualifies for exemption:

- (1) It must be machinery.
- (2) It must be used directly in the manufacturing process.
- (3) It must be incorporated for the first time into plant facilities established in this state.
- (4) It must not replace other machinery.

Section 2. Analysis of Requirements. (1) It must be machinery. The term "machinery" shall mean: machines, in general, or collectively; also, the working parts of a machine, engine, or instrument; as, the machinery of a watch. (Webster's New International Dictionary). This definition does not specify that machinery must have working parts and be able to perform a function in and of itself, as a "machine" would. The machinery of a manufacturing operation is composed of all the components making up the process, including the fixed and nonmoving parts as well as the moving parts. This is illustrated in the example of the machinery of a watch.

(2) It must be used directly in the manufacturing process. Machinery must be intimately involved in production in order to be considered used "directly" in the manufacturing process. The fact that machinery is necessary for a manufacturing process does not automatically qualify it for exemption. A single manufacturer may, within his primary manufacturing process, have more than one (1) production activity.

(a) Primary manufacturing process.

1. The primary manufacturing process is the production operation resulting in a finished product which will be transferred from the producing plant for distribution to customers or for further processing at another plant site. Production begins at a point where the raw material enters a process and is acted upon to change its size, shape, or composition or is transformed in some manner. Production ends when the finished goods are packaged or ready for sale. Packaging is considered complete when the product is in the container in which it is normally received by the purchaser.

2. All activities preceding the point of introduction of the raw material into the manufacturing process and following the point at which the finished product is packaged or ready for sale are not production activities and the machinery used therein is subject to tax.

3. Storage facilities, including those provided for the storage of in-process materials which have been removed from the production line to await further processing, are not used directly in the manufacturing process and are subject to tax. Proximity of storage facilities to the production line is immaterial.

(b) Contributory or secondary manufacturing process. This activity generally falls into one (1) of

four (4) categories:

1. The manufacture of industrial tools to be used in the manufacturing process. Examples include the manufacture of dies, patterns, rolls, molds, cutters and cutter blades, and like property. The exemption for machinery used herein is determined by the same criteria used for determining the exemption provided in the primary manufacturing process.

2. The processing of materials which do not become an ingredient of the finished product but are consumed as industrial supplies directly in the primary manufacturing process. Examples include water cooling systems, bottle washing preparatory to filling, and chemical processes whereby the chemical is used as a catalyst directly on the product being manufactured. This machinery exemption begins at the point where the material is acted upon to condition it for use in the manufacturing process or at the point where it performs a function itself, if it is not acted upon prior to that point. The exemption ends when the material leaves the process.

3. Electrical machinery and similar equipment used directly in the operation of other machinery which is used directly in the manufacturing process.

4. Machinery used exclusively for quality control of in-process material or the efficient operation of machinery. Examples are air cooling or air conditioning systems, control panels, exhaust systems, and similar activities.

(3) It must be incorporated for the first time into plant facilities established in this state. To meet this requirement, the machinery must be installed in this state for the first time and it must be incorporated into plant facilities in this state. Machinery which has been once installed into manufacturing facilities in this state may be subject to tax as provided in 103 KAR 30:200 when subsequently sold by that manufacturer. Machinery purchased and delivered in Kentucky is subject to tax when the machinery is not acquired for installation in Kentucky.

(4) It must not replace other machinery. New machinery purchased to replace other machinery in the plant is subject to tax unless the new machinery performs a different function, manufactures a different product, or has a greater productive capacity, measured by units of production, than the machinery replaced. Modification of machinery to perform a different function or manufacture a different product qualifies for exemption.

Section 3. In all cases where a question arises concerning the exemption of machinery for new and expanded industry, the burden of proof that each qualification has been met is upon the one seeking the exemption. (SU-6-1; 1 Ky.R. 469; eff. 3-12-1975; TAm eff. 6-22-2016.)